

## Internal Revenue Service

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Person To Contact:

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### Legend

Parent =

Corporation Y =

Corporation L =

Corporation M =

Corporation N =

Corporation O =

Year One =

Function A =

F =  
G =

Dear :

This is in reply to your request for a ruling concerning whether Corporation Y, a subsidiary of Parent, will qualify as successor employer for purposes of the annual wage limitations under sections 3121(a)(1) and 3306(b)(1) of the Internal Revenue Code (Code) with respect to wages paid to certain employees who you represent will become employees of Corporation Y in a corporate reorganization in which the employees' employment is intended to be transferred from Corporations L, M, N and O.

#### FACTS

You indicate that the purpose of the reorganization and transfer of employees is to enable Parent to satisfy certain federal regulatory requirements. U.S. employees working for the Parent are currently employed by U.S. subsidiaries of the Parent. Some employees of subsidiaries of the Parent are "Business Employees" who perform business functions that are considered to be revenue generating. Other employees of subsidiaries are "Support Employees" who perform activities in support of the Business Employees and in support of the business operations of the Parent and its subsidiaries. This transaction involves "Support Employees" of four subsidiaries of the Parent, each of which perform some of the Function A Support Functions (Function A Support Employees). The four subsidiaries you characterize as predecessor employers in this transaction for purposes of the annual wage limitation are comprised of Corporations L, M, N and O.

The ruling request discusses the assets of the four subsidiaries that are transferring employees. The request provides that "own" is defined for purposes of the request by reference to an amount carried on the related subsidiary balance sheet or, in the case of contracts, by reference to the signatory. Corporations L, M, N and O own operating assets used by Support Employees and Business Employees. Included among the operating assets are such items as leasehold improvements, computer equipment, telecommunications equipment, software, furniture, fixtures, and contracts. Any operating assets owned by affiliates of the Parent other than Corporations L, M, N and O that are used by the Support Employees and Business Employees of Corporations L, M, N and O, respectively, are made available to such employees through leasing, contractual, and similar intercompany arrangements. Assets owned by such other affiliates of the Parent include commonly shared items such as real property and corporate vehicles, as well as additional computer equipment, telecommunications equipment, furniture, fixtures, and contracts.

Proposed Transaction

In the Transaction, on a date to be determined in Year One after January 1, Corporations L, M, N and O will transfer their respective Function A Support Employees to Corporation Y, a shared service entity. On the same date as the transfer of employees, Corporations L, M, N and O will also transfer to Corporation Y substantially all those operating assets owned by them that are determined to relate to the Function A Support Employees being transferred to Corporation Y. Also, on the same date, Corporation Y will succeed to the leasing, contractual or similar intercompany arrangements with regard to the assets that are owned by Parent's other affiliates and used by the Function A Support Employees.

Immediately after the Transaction, the Function A Support Employees who have transferred will continue to perform their functions supporting Business Employees and business activities of the subsidiary from which they have transferred and other affiliates of the Parent in the same capacity and manner as prior to the transfer. The transferred employees will have the same use of all the assets used in the Function A Support Functions, either through ownership transfer of the assets or through transfer of leasing, contractual or similar intercompany arrangements which the employees were using prior to the transfer.

The taxpayer represents that 100% of the Function A Support Employees of Corporations M and N are common law employees of their respective Corporation before the transfer and that the employees will be transferred to Corporation Y and immediately become the common law employees of Corporation Y. This transfer includes all supervisors and managers within the Function A Support Functions at Corporations M and N. Therefore, according to your representations, at the conclusion of the Transaction, 100% of the Function A Support Employees formerly employed by Corporation M and Corporation N will be employed by Corporation Y and will be under the supervision and direction of supervisors and managers employed by Corporation Y.

The taxpayer represents that 100% of the Function A Support Employees of Corporations L and O are common law employees of their respective Corporation before the transfer and that between F% and G% of the Function A Support Employees will be transferred to Corporation Y and immediately become the common law employees of Corporation Y. Corporations L and O are subject to legal requirements that may limit the transfer of certain employees. This transfer of the Function A Support Employees will include all supervisors and managers within the Function A Support Functions at Corporations L and O, except as limited by legal requirements. Therefore, according to your representations, at the conclusion of the Transaction, between F% and G% of the Function A Support Employees formerly employed by Corporation L and O will be employed by Corporation Y and will be under the supervision and direction of supervisors and managers employed by Corporation Y.

## LAW AND ANALYSIS

FICA taxes are imposed on wages, as defined in section 3121(a) of the Code. FICA taxes are composed of Old-Age, Survivors, and Disability Insurance Tax (social security taxes) and hospital insurance taxes (Medicare taxes). Social security taxes are imposed by sections 3101(a) (employee's portion) and 3111(a) (employer's portion).

Section 3121(a)(1) provides an exception from the social security tax portion of the FICA for remuneration paid by an employer to an employee with respect to employment during the calendar year after the employer has paid wages to the employee equal to the contribution and benefit base for the year. There is generally no exception from wages for an employer because another employer has already paid wages to the employee equal to the contribution and benefit base during the calendar year. Remuneration paid by the second employer is generally subject to social security taxes on remuneration that is not otherwise excepted up to the amount of a new contribution and benefit base applicable to that employer with respect to the employee. Although the employee can obtain a refund of the employee portion of social security taxes on his or her income tax return to the extent the employee portion of social security taxes have been paid on wages in excess of the contribution benefit base as a result of the employee having two or more employers, the employer is not entitled to a refund of the employer portion of social security tax on such wages.

The predecessor-successor rule in section 3121(a)(1) provides an exception to the general rule that a new contribution and benefit base applies in the case of a second employer. Section 3121(a)(1) provides that, if an employer (referred to as a successor employer) during any calendar year "acquires substantially all the property used in a trade or business of another employer (hereinafter referred to as a predecessor), or used in a separate unit of a trade or business of a predecessor, and immediately after the acquisition employs in his trade or business an individual who immediately prior to the acquisition was employed in the trade or business of such predecessor, then, for the purpose of determining whether the successor employer has paid remuneration . . . with respect to employment equal to the contribution and benefit base . . . , to such individual during such calendar year, any remuneration . . . paid with respect to employment paid . . . to such individual by such predecessor during such calendar year and prior to the acquisition shall be considered as having been paid by such successor employer."

Section 31.3121(a)(1)-1(b)(2) of the regulations provides that three tests must be met for the wages paid, by a predecessor to an employee to be, for purposes of the annual wage limitation, treated as having been paid to such employee by a successor:

(i) The successor during a calendar year acquired substantially all the property used in a trade or business, or used in a separate unit of a trade or business, of the predecessor;

(ii) Such employee was employed in the trade or business of the predecessor immediately prior to the acquisition and is employed by the successor in the successor's trade or business immediately after the acquisition; and

(iii) Such wages were paid during the calendar year in which the acquisition occurred and prior to such acquisition.

Section 31.3121(a)(1)-1(b)(3) of the regulations provides that the method of acquisition by an employer of the property of another employer is immaterial. The acquisition may occur as a consequence of the incorporation of a business by a sole proprietor or a partnership, the continuance without interruption of the business of a previously existing partnership by a new partnership or by a sole proprietor, or a purchase or any other transaction whereby substantially all the property used in a trade or business, or used in a separate unit of a trade or business, of one employer is acquired by another employer.

Section 31.3121(a)(1)-1(b)(4) of the regulations provides that substantially all the property used in a separate unit of a trade or business may consist of substantially all the property used in the performance of an essential operation of the trade or business, or it may consist of substantially all the property used in a relatively self-sustaining entity which forms a part of the trade or business.

Section 31.3121(a)(1)-1(b)(4) of the regulations provides two examples of the requirement that the successor acquired substantially all the property used in a separate unit of a trade or business. In Example 1, the M Corporation, which is engaged in the manufacture of automobiles, including the manufacture of automobile engines, discontinues the manufacture of the engines and transfers all the property used in such manufacturing operation to the N Company. Under the regulations, the N Company is considered to have acquired a separate unit of the trade or business of the M Corporation, namely, its engine manufacturing unit. In Example 2, the R Corporation which is engaged in the operation of a chain of grocery stores transfers one of such stores to the S Company. The regulations provide that the S Company is considered to have acquired a separate unit of the trade or business of the R Corporation.

Section 31.3121(a)(1)-1(b)(5) of the regulations provides that a successor may receive credit for wages paid to an employee by a predecessor only if immediately prior to the acquisition the employee was employed by the predecessor in his trade or business which was acquired by the successor and if immediately after the acquisition such employee is employed by the successor in his trade or business (whether or not in the same trade or business in which the acquired property is used). If the acquisition involves only a separate unit of a trade or business of the predecessor, the employee need not have been employed by the predecessor in that unit provided he was employed in the trade or business of which the acquired unit was a part.

Rev. Rul. 68-105, 1968-1 C.B. 418, considered the issue of whether an employer who is a successful bidder for a United States Air Force (USAF) maintenance contract may qualify as a successor employer to the prior contractor under a similar contract for purposes of applying the annual wage limitations provided by section 3121(a)(1). The maintenance contract required the contractor to maintain, repair, and overhaul USAF airplanes. For the work on the contract, the contractor used Government-owned equipment and tooling of substantial value. The equipment was provided to the contractor through an inventory accounting arrangement.

Under the facts of Rev. Rul. 68-105, on July 1 of the calendar year, a new employer assumed responsibility under a similar contract, obtained on a competitive bid. All Government-owned property formerly used by the first employer was turned over to the second employer for use in a continuous, unbroken performance of the maintenance job the first employer had been doing. Thus, the second employer acquired the possession and use of all the Government-owned property used in the maintenance operation through an inventory accounting arrangement similar to that made with the first employer.

Rev. Rul. 68-105 concludes that, under the facts of the ruling, because the second employer obtained the possession and use of all the Government-owned property used by the first employer it satisfies the requirement of acquiring substantially all of the property used in the separate unit of the trade or business. The ruling states that it is immaterial that the second employer did not acquire an interest in the property used in performing the contract from the first employer. Because the other requirements for being a successor employer under section 3121(a)(1) were also met, the ruling concludes that the second employer is a successor employer of the first employer for purposes of the annual wage limitation under section 3121(a)(1).

Rev. Rul. 72-269, 1972-1 C.B. 313, considered whether a subcontractor performing an essential operation under a government contract may treat wages paid by a predecessor employer, formerly the prime contractor, as paid by the subcontractor for purposes of the annual wage limitation provisions of the FICA and the FUTA. Under the facts of the ruling, for some years one employer was the operating contractor for the United States Atomic Energy Commission (AEC) in the operation of one of its facilities. Upon expiration of the first employer's contract on June 30, the operation of that facility was transferred under an AEC contract to a second employer. The second employer had entered into a contract with a third employer for the performance of an essential operation of the facility then under contract by the AEC to the first employer. The subcontract was effective July 1, simultaneously with the second employer's government contract. Under the subcontract, the third employer gained operating control of, and was responsible and held accountable for, substantial Government-owned property and equipment related to the essential operation of the facility.

Rev. Rul. 72-269 concludes that the third employer meets the requirement to acquire substantially all the assets in a separate unit of a trade or business, and states that inasmuch as the third employer acquired the use of the Government-owned property used by the first employer in an essential operation of the facility, it is immaterial that the third employer did not acquire an interest in the property used in performing the subcontract. Because the other requirements necessary to qualify to take the wages of the predecessor into account for purposes of section 3121(a)(1) and 3306(b)(1) were also met, the ruling concluded that the third employer qualified as a successor employer to take into account the wages of the predecessor first employer in determining whether the annual wage limitation for FICA and FUTA were met.

As noted above, section 31.3121(a)(1)-1(b)(2) of the regulations provides that three requirements must be met for the wages paid, by a predecessor to an employee to be, for purposes of the annual wage limitation, treated as having been paid to such employee by a successor. The first requirement is that the successor during a calendar year acquired substantially all the property used in a trade or business, or used in a separate unit of a trade or business, of the predecessor. Section 31.3121(a)(1)-1(b)(4) of the regulations provides that substantially all of the property used in a separate unit of a trade or business may consist of substantially all the property used in the performance of an essential operation of a trade or business, or it may consist of substantially all the property used in a relatively self-sustaining entity which forms a part of the trade or business.

The first test is met because Corporation Y has acquired substantially all the assets of an essential operation of Corporations L, M, N and O because it meets this test as interpreted by Rev. Rul. 72-269. Rev. Rul. 72-269 concludes that a successor employer meets the requirement to acquire substantially all the assets in a separate unit of a trade or business (or essential operation), if the successor employer acquires the use of the property used by the predecessor in the essential operation. It is represented for purposes of the ruling request that Corporations L, M, N and O will transfer to Corporation Y all those operating assets owned by each respective Corporation that are determined to relate to their respective Function A Support Employees transferring to Corporation Y. Corporation Y will also succeed to the leasing, contractual, or similar intercompany arrangements with regard to the assets that are owned by the taxpayer's other affiliates and used by the Function A Support Employees. Based on the specific facts presented, the Function A Support Functions constitute essential operations of Corporations L, M, N and O because the operations are necessary to complete or support a process executed by Business Employees or other Support Employees in the conduct of their activities and to enable Parent to meet all of its management, administration, reporting, compliance, legal, financial, risk, technological, and operational obligations that are germane to Parent's business. The Function A Support Functions are distinct and substantial operations that provide activities that are essential for the operations of Corporations L, M, N and O. Accordingly, because Corporation Y

is acquiring substantially all the assets of essential operations (Function A Support Functions) of Corporation L, M, N and O, the first test is met.

The second requirement is that employees to whom the predecessor paid wages must have been employed in the trade or business of the predecessor immediately prior to the acquisition and must be employed by the successor in the successor's trade or business immediately after the acquisition. Parent has represented that the Function A Support Employees being transferred are the common law employees of Corporations L, M, N and O in the Function A Support Functions' trade or business of Corporations L, M, N and O immediately prior to the acquisition and will be common law employees of Corporation Y in Corporation Y's trade or business immediately after the acquisition. Based on that representation, the second requirement is also met.

The third requirement is that such wages were paid during the calendar year in which the acquisition occurred and prior to such acquisition. According to the taxpayer, because of the date of the acquisition, wages will be paid by the predecessor during the calendar year in which the acquisition will occur and prior to such acquisition.

Therefore, we conclude that, with regard to the Transaction, Corporation Y is a successor employer of Corporations L, M, N and O for purposes of the annual wage limitations contained in sections 3121(a)(1) and 3306(b)(1).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, the ruling is based on the representation that, after the Transaction, the transferred Function A Support Employees will be common law employees of Corporation Y rather than Corporations L, M, N or O, respectively and is not a separate ruling on the identification of the common law employer based of all the facts and circumstances. Furthermore, the ruling only applies with respect to wages paid to a particular Function A Support Employee if the employee becomes an employee of Corporation Y after the Transaction.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.



In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Lynne Camillo  
Branch Chief, Employment Tax Branch 2 (Exempt  
Organizations/Employment Tax/Government  
Entities)  
(Tax Exempt & Government Entities)